

REPORT OF EXAMINATION  
OF THE  
FAIRMONT PREMIER INSURANCE COMPANY  
  
AS OF  
DECEMBER 31, 2005

Participating State  
and Zone:

California  
Delaware, Zone 1 – Northeastern

Filed June 28, 2007

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Los Angeles, California  
May 29, 2007

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Kent Michie  
Secretary, Zone IV-Western  
Commissioner of Insurance  
Department of Insurance, State of Utah  
Salt Lake City, Utah

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Honorable Thomas E. Hampton  
Secretary, Zone I-Northeastern  
Commissioner of Insurance  
Department of Insurance, Securities and Banking  
Washington, D.C.

Dear Chairman, Secretaries and Commissioner:

Pursuant to your instructions, an examination was made of the

#### FAIRMONT PREMIER INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records at 10777 Westheimer Road, Houston, Texas 77042. The Company's statutory home office is located at 8880 Rio San Diego Drive, Suite 510, San Diego, California 92108.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2005. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. An examiner from Delaware, representing Zone I-Northeastern of the NAIC, participated in the examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; loss experience; growth of company; business in force by states; and sales and advertising.

This examination was conducted in conjunction with the examination of the Company's parent, TIG Insurance Company and three affiliates, TIG Specialty Insurance Company, TIG Indemnity Company, and Fairmont Insurance Company.

### SUMMARY OF SIGNIFICANT FINDINGS

As a result of this examination, surplus as regards policyholders as of December 31, 2005, has been reduced by \$8.8 million. The reduction in surplus was due to decreases in the admitted values of common stocks and aggregate write-ins for other than invested assets.

### SUBSEQUENT EVENTS

Effective January 1, 2006, the Fairmont Specialty Group of Companies (including the Company) were placed into run-off and subject business would subsequently be carried on as the "Fairmont Specialty Division" of the affiliated Crum & Forster (C&F) group of companies. Consequently the Company retained calendar year 2004 and 2005 business, as well as unearned premiums in-force at December 31, 2005, as they earn off during 2006. United States Fire Insurance Company an affiliate will service the business. Once the C&F companies acquire the proper rate, form filing approvals, and licensing, the business will no longer be written or renewed by the Fairmont Specialty Group.

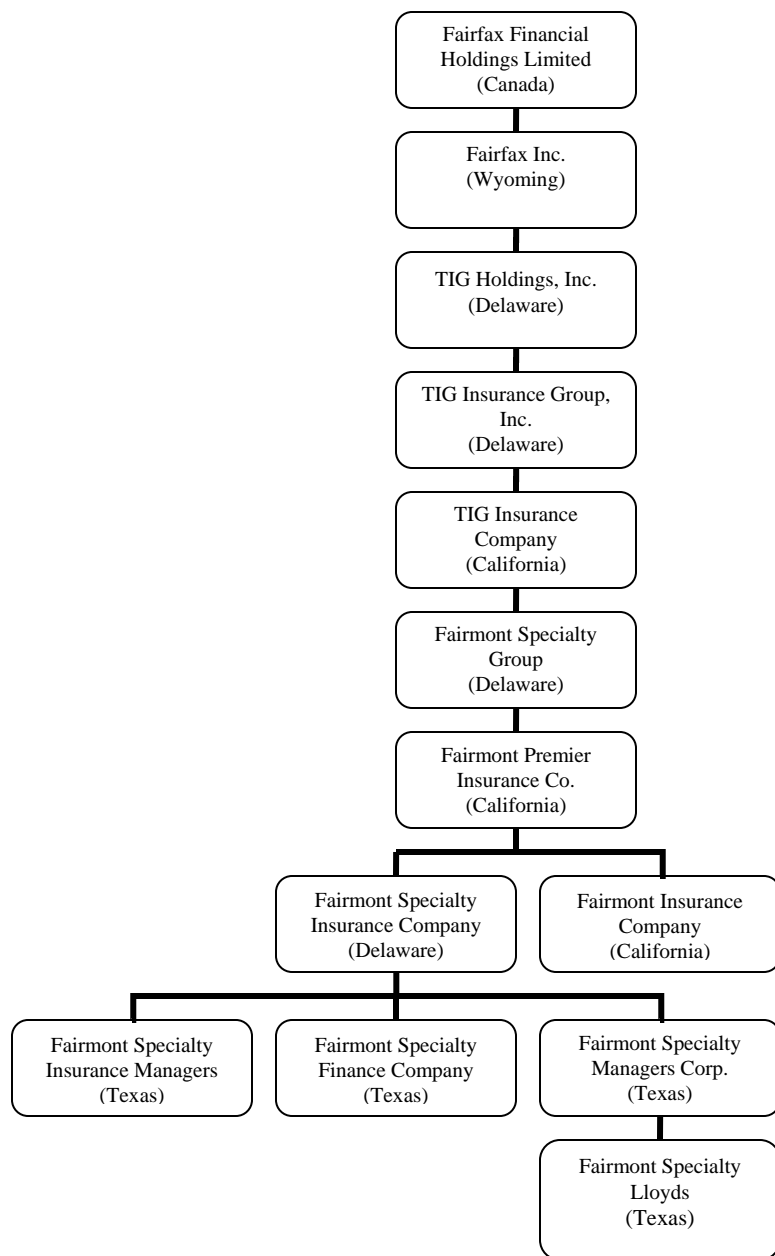
## COMPANY HISTORY

On December 23, 2005, Fairmont Specialty Group Inc. (FSG), the Company's immediate parent, was sold to TIG Insurance Company (TIG) along with all of FSG's subsidiary companies including the Company. The California Department of Insurance (CDI) approved this transaction on December 22, 2005. TIG exchanged 7,744,125 shares of common stock of its publicly traded affiliate Odyssey Reinsurance Holding Corporation (ORHC) for 100% of the FSG shares. The total purchase price was stated at \$138.4 million, which approximated the statutory surplus of the FSG shares acquired. There was no goodwill recorded as a result of this transaction.

On December 28, 2005, The Company's ultimate parent, Fairfax Financial Holdings Limited (Fairfax) announced that, effective January 1, 2006, the Fairmont Specialty Group of Companies (including the Company) would be placed into run-off and that subject business would subsequently be carried on as the "Fairmont Specialty Division" of the affiliated Crum & Forster group of companies. Pursuant to the "Restructuring Plan for Fairmont Specialty Group" it was the stated intention that Crum & Forster Holding, Inc. (C&F) insurance subsidiaries, including United States Fire Insurance Company (U.S. Fire) will ultimately write the new and renewal Fairmont Specialty Division business. However, Fairmont Specialty Division business cannot be written by C&F insurers immediately in some jurisdictions due to rate and form filing requirements and certain C&F insurers need to be licensed for additional lines of insurance in some states. For these reasons the business on a go-forward basis continues to be written by the Fairmont Specialty Group of companies and is then 100% reinsured with U.S. Fire.

## MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the top tier holding companies, the Company's immediate parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



all ownership is 100%.

Management of the Company is vested in a four-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2005, follows:

### Directors

| <u>Name and Residence</u>              | <u>Principal Business Affiliation</u>                      |
|--|--|
| Marc J. Adee<br>Houston, Texas         | President<br>Fairmont Specialty Group, Inc.                |
| Loyd R. Godbold<br>Tomball, Texas      | Senior Vice President<br>Fairmont Specialty Group, Inc.    |
| David O. Green<br>The Woodlands, Texas | Executive Vice President<br>Fairmont Specialty Group, Inc. |
| Sharlene J. Husky<br>Humble, Texas     | Vice President<br>Fairmont Specialty Group, Inc.           |

### Principal Officers

| <u>Name</u>            | <u>Title</u>                           |
|------------------------|--|
| Marc J. Adee           | President                              |
| Sharlene J. Husky      | Senior Vice President and Secretary    |
| Paul M. Mundy          | Assistant Vice President and Treasurer |
| David O. Green         | Executive Vice President               |
| Loyd R. Godbold        | Senior Vice President                  |
| Chris S. Throckmorton  | Senior Vice President and Actuary      |
| Nicole B. Smith        | Senior Vice President                  |
| Gary J. McGeddy        | Executive Vice President               |
| Lloyd F. Chaffin       | Executive Vice President               |
| Richard J. Klimazewski | Executive Vice President               |
| Gus E. Aivaliotis      | Vice President                         |
| Jill S. Everett        | Vice President                         |

### Management Agreements

Tax allocation agreement: The Company is party to an agreement with TIG Holding, Inc., dated January 1, 2000, whereby it files its' federal income taxes on a consolidated basis along with 50 other affiliated companies. Each company computes its' federal income tax liability or refunds on a separate basis and settles with its parent. This agreement was approved by the California Department

of Insurance (CDI) on January 22, 2001. The Company's portion of the federal income tax incurred for 2005 was \$598,000.

**Investment Agreement:** The Company is party to an agreement with Hamblin Watsa Investment Counsel Ltd. (HWIC), and Fairfax Financial Holdings Limited (Fairfax ) effective January 1, 2003. Pursuant to the agreement, HWIC manages the investments of the Company in accordance with specific investment objectives outlined in the agreement. All fees are paid by the Company to Fairfax and Fairfax reimburses HWIC for investment management services. HWIC is a subsidiary of Fairfax. The CDI approved the agreement on December 3, 2003. The fees paid by the Company during 2005 was \$171,000.

**Administrative Services Agreement:** The Company and its insurance subsidiaries, Fairmont Insurance Company (FIC) and Fairmont Specialty Insurance Company (FSIC) entered into this agreement as of January 1, 2004, in conjunction with an Inter-Company Reinsurance Pooling Agreement. According to the agreement, the Company acts as manager for the parties to the agreement and performs underwriting, claims and litigation management and related administrative services for the pooled business. Expenses for services provided by the manager were allocated among the parties. This agreement was approved by the CDI on December 29, 2003.

**Expense Sharing Agreement:** The Company and its insurance subsidiaries, FIC and FSIC, entered into this agreement as of January 1, 2004. Under the terms of the agreement, the Company makes available to the others all personnel and personnel services office space, supplies, business equipment, furniture, fixtures, facilities and shared functions. The Company allocates the cost of such services and facilities on an equitable basis, among the parties. This agreement was approved by the CDI on December 29, 2003.

Subsequently, on January 1, 2006, the functions of the above Administrative Services Agreement and Expense Sharing Agreement were no longer applicable due to the restructuring and assumption of those responsibilities by United States Fire Insurance Company (U.S.Fire). During 2005, the service fees incurred by the Company, was \$10,909,000 pursuant to these two agreements.

Information Technology Services Agreement: FSIC was party to a written agreement with the affiliated Fairfax Information Technology Services, Inc. (FITS) effective December 31, 2001 and having a six-year term (expiring July 31, 2006). Pursuant to this written agreement FITS is authorized to manage and provide information technology services to FSIC. Although not named on the agreement, FITS is also providing identical information technology services to the Company and FIC on a fee basis. Evidently, because the Company and FIC are not named on the agreement, the agreement had not been submitted to the CDI for approval. It is recommended that the Company submit an amended information technology services agreement, to include the Company and FIC as parties to the agreement, to the CDI for approval. During 2005, the service fees paid to FITS by the Company was \$1,463,000.

Pursuant to the December 2005 restructuring, as discussed in the Company History section of this report, the Company entered into the following agreements:

Claims Service and Management Agreement: Pursuant to this agreement, and effective January 1, 2006, claims and management services including underwriting, administration, and financial, will be provided to the Fairmont Specialty Group companies on a cost reimbursement basis by United States Fire Insurance Company (U.S. Fire). This claims service and management agreement was approved by the CDI on December 30, 2005.

Business and Personnel Transfer Agreement: Pursuant to the Business and Personnel Transfer Agreement, and Effective January 1, 2006, U.S. Fire acquired and employed certain personnel (and related employee benefit plans and obligations) from FSG and its insurance subsidiaries including the Company. This defined the transferred assets, including but not limited to, the transfer of existing reinsurance arrangements and defined the transfer of certain liabilities to be assumed by U.S. Fire. This agreement was approved by the CDI on December 23, 2005.

## CORPORATE RECORDS

The Company's board actions regarding the authorization and approval of investments did not satisfy the requirements of California Insurance Code (CIC) Sections 1200 and 1201. The Company's minutes failed to document the authorization or approval of its investments during 2005, which is in violation of CIC Section 1200. In addition, specific references to amounts, facts and the values of the securities were not included as required under CIC Section 1201. It is recommended that the Company implement procedures to ensure future compliance with CIC Sections 1200 and 1201.

## TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed to transact multiple lines of property and casualty insurance in the District of Columbia and all states except New Hampshire and New York. The Company has an application pending with the California Department of Insurance to amend its certificate of authority to withdraw from writing automobile insurance business in California.

In 2005, the Company wrote \$66.9 million of direct premiums. Of the direct premiums written, 42% of the direct premiums were group A&H, 18% workers' compensation, 14% inland marine, 3% commercial multiple peril, and the remaining 23% were in various other lines of business.

The Company's parent, Fairmont Specialty Group, Inc. (FSG) operates as three distinct business units: 1) bail, and special property and casualty focusing on specialty niche markets with a concentration on short-tailed casualty programs based in Houston, Texas; 2) accident and health, based in Tinton Falls, New Jersey, focusing on a variety of specialty coverage's; and 3) Hawaii property and casualty, based in Honolulu, Hawaii, focusing on personal lines and small commercial business insurance in Hawaii.

The Company's business is written through approximately 80 licensed and appointed agents.

## REINSURANCE

### Inter-Company Reinsurance Pooling Agreement

The Company and its insurance subsidiaries, Fairmont Insurance Company (FIC) and Fairmont Specialty Insurance Company (FSIC) entered into this agreement as of January 1, 2004. Under the terms of the agreement FIC and FSIC cede 100% of their net business to the Company. The Company, after retaining 20% of the pooled business returns the remaining amount back to the participants in the following percentages: 67% to FSIC and 13% to FIC. This agreement was approved by the California Department of Insurance on December 23, 2003.

### Assumed

The Company assumes business from FSIC and FIC pursuant to the aforementioned pooling agreement.

### Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2005:

| Lines Reinsured or Type                               | Name of Reinsurer   | Company Retention | Treaty Limits                      |
|---|---|-------------------|------------------------------------|
| First Casualty Excess Liability Workers' Compensation | Swiss Reinsurance America Corp - 80%,<br>nSpire Re Ltd - 20%  | \$1.5 million     | \$4.5 million excess \$1.5 million |
| Second Casualty Clash Liability Workers' Compensation | Arch Reinsurance - 25%,<br>Endurance Specialty Ins. Ltd. - 20%,<br>Lloyds Syndicates - 25%,<br>nSpire Re. Ltd. - 10%,<br>Platinum Underwrites Reinsurance - 20%           | \$6 million       | \$5 million excess \$6 million     |
| Third Casualty Clash Liability Workers' Compensation  | Arch Reinsurance - 25%,<br>Endurance Specialty Ins. Ltd. - 20%,<br>Lloyds Syndicates - 25%,<br>Hannover Life Reinsurance - 10%,<br>Platinum Underwrites Reinsurance - 20% | \$11 million      | \$9 million excess \$11 million    |
| Specialty Umbrella Quota                              | Swiss Reinsurance America Corp  | \$1 million       | 80% of \$5 million                 |

| Lines Reinsured or Type                                   | Name of Reinsurer            | Company Retention                                    | Treaty Limits                          |
|---|------------------------------|--|--|
| Share Casualty Loss Occurrence                            | - 80%                        | primary plus 20% of \$5 million Umbrella             | after the primary                      |
| Hawaii Umbrella Quota Share Casualty Risk attach          | General Reinsurance Co. 80%  | \$1 million primary plus 20% of \$5 million Umbrella | 80% of \$5 million after the primary   |
| Boiler and Machinery property Quota Share, Risks attached | Hartford Steam Boiler        | Zero   | 100% of \$25 million                   |
| Property per risk excess of loss occurrence               | General Reinsurance Co. 100% | \$1 million  | \$1 million excess \$1 million         |
| Property per risk excess of loss occurrence               | General Reinsurance Co. 100% | \$2 million  | \$3 million excess \$2 million         |
| Property per risk excess of loss occurrence               | General Reinsurance Co. 100% | \$5 million  | \$5 million excess \$5 million         |
| Hawaii property per risk excess of loss occurrence        | General Reinsurance Co. 100% | \$1 million  | \$1 million excess \$1 million         |
| Hawaii property per risk excess of loss occurrence        | General Reinsurance Co. 100% | \$2 million  | \$3 million excess \$2 million         |
| Property Catastrophe per risk excess of loss              | General Reinsurance Co. 100% | \$2 million  | 95% of \$18 million excess \$2 million |

Effective January 1, 2006, the Company entered into a “Transition Period Reinsurance and Services Agreement” in which a 100% quota-share of the Fairmont Specialty Group’s pooled business was ceded to an affiliate, United States Fire Insurance Company (U.S. Fire). The subject business was defined as Fairmont Specialty Group policies with effective dates of January 1, 2006 or later. Unearned premiums in-force at December 31, 2005 was not subject to this quota share cession. As part of this agreement the reinsurer agrees to perform underwriting, administration, financial and claims services with respect to the subject business. This agreement was approved by the CDI on December 23, 2005.

As of December 31, 2005, reinsurance recoverable, for all ceded reinsurance totaled \$170.7 million or 124% of surplus as regards policyholders. \$37.8 million and \$119.4 million of the ceded reinsurance recoverables were from FIC and FSIC, respectively, pursuant to the pooling arrangement.

## ACCOUNTS AND RECORDS

Due to the aforementioned 2005 restructuring the records, and staff members supporting the financial statements, changed from Texas to New Hampshire while the examination was being conducted.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2004 through December 31, 2005

Reconciliation of Examination Changes as of December 31, 2005

Statement of Financial Condition  
as of December 31, 2005

| <u>Assets</u>  | <u>Ledger and<br/>Nonledger<br/>Assets</u> | <u>Assets Not<br/>Admitted</u> | <u>Net Admitted<br/>Assets</u> | <u>Notes</u> |
|--|--|--------------------------------|--------------------------------|--------------|
| Bonds  | \$ 25,519,128                              | \$                             | \$ 25,519,128                  |              |
| Stocks:  |  |                                |                                |              |
| Common stocks  | 116,211,911                                | 7,841,967                      | 108,369,944                    | (1)          |
| Cash and short-term investments  | 35,030,227                                 |                                | 35,030,227                     |              |
| Receivables for securities   | 32,549                                     |                                | 32,549                         |              |
| Investment income due and accrued  | 402,067                                    |                                | 402,067                        |              |
| Agents' balances or uncollected premiums:  |  |                                |                                |              |
| Premiums and agents' balances in course of collection                              | 3,589,943                                  | 637,734                        | 2,952,209                      |              |
| Premiums, agents' balances and installments booked<br>but deferred and not yet due | 1,933,047                                  |                                | 1,933,047                      |              |
| Reinsurance:   |  |                                |                                |              |
| Amounts recoverable from reinsurers  | 1,651,205                                  |                                | 1,651,205                      |              |
| Funds held by or deposited with reinsured companies                                | 796,619                                    |                                | 796,619                        |              |
| Current federal income tax recoverable   | 169,004                                    |                                | 169,004                        |              |
| Net deferred tax assets  | 2,319,673                                  | 989,179                        | 1,330,494                      |              |
| Guaranty funds receivable or on deposit  | 207,533                                    |                                | 207,533                        |              |
| Aggregate write-ins for other than invested assets                                 | <u>4,564,111</u>                           | <u>3,723,378</u>               | <u>840,733</u>                 | (2)          |
| Total assets   | <u>\$ 192,427,017</u>                      | <u>\$ 13,192,258</u>           | <u>\$ 179,234,759</u>          |              |
| <u>Liabilities, Surplus and Other Funds</u>  |  |                                |                                |              |
| Losses   |  |                                | \$ 21,872,414                  | (3)          |
| Reinsurance payable on paid losses<br>and loss adjustment expenses                 |  |                                | (1,117,085)                    |              |
| Loss adjustment expenses   |  |                                | 7,361,356                      | (3)          |
| Commissions payable, contingent commissions  |  |                                | 721,491                        |              |
| Other expenses   |  |                                | 840,867                        |              |
| Taxes, licenses and fees   |  |                                | 412,413                        |              |
| Unearned premiums  |  |                                | 10,778,853                     |              |
| Ceded reinsurance premiums payable   |  |                                | 1,076,007                      |              |
| Funds held by company under reinsurance treaties                                   |  |                                | 871,675                        |              |
| Amounts withheld or retained by company for others                                 |  |                                | 364,771                        |              |
| Provision for reinsurance  |  |                                | 346,866                        |              |
| Payable to parent, subsidiaries and affiliates                                     |  |                                | 5,849,320                      |              |
| Aggregate write-ins for liabilities  |  |                                | <u>1,430,000</u>               |              |
| Total liabilities  |  |                                | 50,808,948                     |              |
| Common capital stock   |  | \$ 3,808,000                   |                                |              |
| Gross paid-in and contributed surplus  |  | 117,984,620                    |                                |              |
| Unassigned funds (surplus)   |  | <u>6,633,191</u>               |                                |              |
| Surplus as regards policyholders   |  |                                | <u>128,425,811</u>             |              |
| Total liabilities, surplus and other funds   |  |                                | <u>\$ 179,234,759</u>          |              |

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

|                                      |                   |                   |
|--------------------------------------|-------------------|-------------------|
| Premiums earned                      |                   | \$ 32,201,189     |
| Deductions:                          |                   |                   |
| Losses incurred                      | \$ 16,644,149     |                   |
| Loss expenses incurred               | 3,724,405         |                   |
| Other underwriting expenses incurred | <u>10,909,397</u> |                   |
| Total underwriting deductions        |                   | <u>31,277,951</u> |
| Net underwriting gain                |                   | 923,238           |

Investment Income

|                              |                  |           |
|------------------------------|------------------|-----------|
| Net investment income earned | \$ 1,528,738     |           |
| Net realized capital gains   | <u>1,550,915</u> |           |
| Net investment gain          |                  | 3,079,653 |

Other Income

|  |                    |                     |
|--|--------------------|---------------------|
| Net loss from agents' balances charged off | <u>\$ (97,005)</u> |                     |
| Total other income                         |                    | <u>(97,005)</u>     |
| Net income before federal income taxes     |                    | 3,905,886           |
| Federal and foreign income taxes incurred  |                    | <u>598,298</u>      |
| Net income                                 |                    | <u>\$ 3,307,588</u> |

Capital and Surplus Account

|   |                |                       |
|---|----------------|-----------------------|
| Surplus as regards policyholders, December 31, 2004       |                | \$ 119,915,917        |
| Net income  | \$ 3,307,588   |                       |
| Change in unrealized capital gains less capital gains tax | 13,103,523     |                       |
| Change in net unrealized foreign exchange capital (loss)  | (25,523)       |                       |
| Change in net deferred income tax                         | 573,050        |                       |
| Change in nonadmitted assets                              | (8,737,825)    |                       |
| Change in provision for reinsurance                       | <u>289,081</u> |                       |
| Change in surplus as regards policyholders for the year   |                | <u>8,509,894</u>      |
| Surplus as regards policyholders, December 31, 2005       |                | <u>\$ 128,425,811</u> |

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2004 through December 31, 2005

|   |                |
|---|----------------|
| Surplus as regards policyholders, December 31, 2004,<br>per Examination | \$ 115,716,403 |
|---|----------------|

|   | Gain in<br>Surplus | Loss in<br>Surplus |
|---|--------------------|--------------------|
| Net income  | \$ 3,307,588       | \$                 |
| Change in net unrealized capital gains                                  | 13,103,523         |                    |
| Change in net unrealized foreign exchange capital loss                  |                    | 25,523             |
| Change in net deferred income tax                                       | 573,050            |                    |
| Change in nonadmitted assets  |                    | 4,538,311          |
| Change in provision for reinsurance                                     | 289,081            |                    |
| Total   | \$ 17,273,242      | \$ 4,563,834       |
| Net increase in surplus as regards policyholders                        |                    | 12,709,408         |
| Surplus as regards policyholders, December 31, 2005,<br>per Examination |                    | \$ 128,425,811     |

Reconciliation of Examination Changes  
as of December 31, 2005

|  | <u>Per<br/>Company</u> | <u>Per<br/>Examination</u> | <u>Surplus<br/>Increase<br/>(Decrease)</u> | <u>Notes</u> |
|--|------------------------|----------------------------|--|--------------|
| <u>Assets</u>  |                        |                            |  |              |
| Common stocks  | \$ 116,211,911         | \$108,369,944              | \$ (7,841,967)                             | (1)          |
| Aggregate write-ins for other than invested assets                     | 1,794,955              | 840,733                    | <u>(954,222)</u>                           | (2)          |
| Net decrease to surplus as regards policyholders                       |                        |                            | (8,796,189)                                |              |
| Surplus as regards policyholders,<br>December 31, 2005 per Company     |                        |                            | <u>137,222,000</u>                         |              |
| Surplus as regards policyholders,<br>December 31, 2005 per Examination |                        |                            | <u>\$128,425,811</u>                       |              |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Common Stocks

The captioned account was overstated by the amount of \$7,841,967 at December 31, 2005. The following schedule depicts the Company carried versus examination determined admissible values for the specific common stocks:

| <u>Description</u>               | <u>Company</u>       | <u>Examination</u>   | <u>Difference</u>  |
|----------------------------------|----------------------|----------------------|--------------------|
| Advent Capital Holdings PLC      | \$ 977,578           | \$ 299,578           | \$ 678,000         |
| Fairmont Specialty Insurance Co. | 96,805,993           | 90,594,283           | 6,211,710          |
| Fairmont Insurance Company       | <u>18,428,340</u>    | <u>17,476,083</u>    | <u>952,257</u>     |
| Totals                           | <u>\$116,211,911</u> | <u>\$108,369,944</u> | <u>\$7,841,967</u> |

The Company valued its common stock investment of Advent Capital Holdings PLC (Advent), a foreign affiliate, using a quoted market value from a non-qualifying stock exchange. Pursuant to Statement of Statutory Accounting Principles (SSAP) No. 88 the examiners reduced the admitted value of the Company's investment in Advent by \$678,000 to reflect the adjusted U.S. GAAP audited equity amount described below. It is noted that subsequent to the issuance of its 2005 Annual Statement the Company contacted the California Department of Insurance (CDI), disclosing that the valuation approach they had used differed from SSAP No. 88, due to the lack of availability of GAAP audited financial statements. In May 2006, United Kingdom GAAP audited financial statements of Advent became available, the Company then prepared a reconciliation to U.S. GAAP, further statutory adjustments were then made, and the updated values used to adjust carrying values in the next quarterly period.

Fairmont Specialty Insurance Company (FSIC) was concurrently examined by the Delaware Department of Insurance (DDI). The surplus as regards policyholders at December 31, 2005, for FSIC, as determined by the DDI, was used in valuing FSIC for the purposes of this report.

Fairmont Insurance Company (FIC) was concurrently examined by the CDI. The surplus as regards policyholders at December 31, 2005 for FIC, as determined by the CDI, was used in valuing FIC for the purposes of this report.

(2) Aggregate Write-ins for Other Than Invested Assets

The captioned account was reduced by a net amount of \$954,222. Included within this heading were two balances identified as A&H Loss Funding, and TRG Loss Draft Payable, which carried material balances receivable at year-end. Based on discussion with Company personnel, and documentation provided, it appeared that the balances were generally uncollectible. It is recommended that the Company investigate the contents of these accounts and comply with SSAP No. 6, paragraph 9.a regarding the aging of accounts.

(3) Losses and Loss Adjustment Expenses

The CDI directed the Company, under California Insurance Code Section 733, to retain the actuarial firm of Petit Actuarial Group, LLC (Petit) for the purpose of assisting this examination in determining the reasonableness of the Company's loss and loss adjustment expense reserves. Based on the analysis by Petit, and the review of their work by a Casualty Actuary from the CDI, the Company's December 31, 2005, reserves for losses and loss adjustment expenses were determined to be reasonably stated.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control– Information Technology Services Agreement (Page 7): An affiliate, Fairfax Information Technology Services, Inc., provided information technology services although the Company is not named on a supporting written agreement. Service arrangements with affiliates require submission to the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) 1215.5(b). It is recommended that the Company submit an amended information

technology services agreement, to include the Company and Fairmont Insurance Company as parties to the agreement, to the CDI for approval.

Corporate Records (Page 8): It is recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Sections 1200 and 1201.

#### Previous Report of Examination

Management and Control- Inter-Company Agreements (Page 6): It was recommended that all inter-company agreements be amended to reflect the new names of the Fairmont companies. The inter-company agreements have not been so amended, however, due to the recent restructuring certain of the agreements have effectively been replaced by new agreements between United States Fire Insurance Company and the Company and the new agreements utilize current company names.

Corporate Records- Minutes (Page 7): It was recommended that the corporate minutes should reflect complete details of the meetings of the board of directors as required by Section IV of the Company's bylaws. As indicated within the above caption "current report of examination" there did not appear to be board or committee records kept concerning ratification of investment transaction by the board during 2005.

Corporate Records- Conflict of Interest Statements (Page 7): It was recommended that the officers and employees of the Company execute conflict of interest statements annually. Applicable signed conflict of interest disclosures were provided during 2005.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

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